

BOARD ACTION MEMORANDUM

TO: NCUA Board
FROM: Director , Office of
Corporate Credit Unions

DATE: April 12, 2011
SUBJ: Approval of Credit Union
Service Organization
(CUSO) Activities

ACTION ITEM: NCUA Board approval of corporate credit union credit union service organization (CUSO) activities not similar to an activity authorized for natural person federal credit union CUSOs.

ACTION DATE: April 21, 2011

OTHER OFFICES CONSULTED: Office of General Counsel, and the Office of Examination and Insurance.

VIEWS OF OTHER OFFICES CONSULTED: Concur.

SUBMITTED TO THE INSPECTOR GENERAL FOR REVIEW:

BUDGET IMPACT, IF ANY: None.

RESPONSIBLE STAFF MEMBERS: Senior Corporate Program Specialist Yvonne Applonie and Staff Attorney Lisa Henderson.

SUMMARY:

Background

The NCUA Board (NCUAB) adopted revisions to NCUA Rules and Regulations Part 704 (“final rule”) governing corporate credit unions (CCU) on September 24, 2010. The final rule restricts corporate credit union service organizations (CUSO) to engaging only in categories of services preapproved by NCUA. The final rule specifies two permissible activities a) brokerage services, and b) investment advisory services; while requiring CCUs to seek NCUA approval for all other CUSO activities. CCU CUSOs primarily serve natural person credit unions (NPCU) and the activities offered are designed to meet the operational needs of the NPCUs. A large number of NPCUs utilize the services of CCU CUSOs, which can present concentration risk as well as systemic risk to the credit union system and the National Credit Union Share Insurance Fund (NCUSIF). The intent of the regulatory changes was to allow NCUA to review corporate CUSO activities for their potential impact on the NCUSIF.

To expedite the CCU CUSO review and approval process, the NCUAB, in September 2010, authorized the Director of OCCU, with the concurrence of the Director of the

Office of Examination and Insurance and the General Counsel, to approve, limit or disapprove requests for CCU CUSO activities which are similar in nature to the approved federal NPCU CUSO activities (as listed in 12 C.F.R. §712.5). CCU CUSO approval requests for activities which are not similar to those activities as listed in 12 C.F.R. §712.5 require NCUA Board approval.

OCCU reviewed corporate CUSO activity requests to assess whether the activity is suitable for CCUs, supports the normal course of business for NPCUs, and identified the risks associated with the activities and their potential impact to the NCUSIF. The activities listed in the table below (Web Development, Hosting, & Content Management; Web Authentication and Security Monitoring; Software Systems Development / Application Programming Interface (API) Development; Secure Collaboration Services; Information Technology (IT) Consulting and Management Services; and Asset Liability Management (ALM) Consulting, Advisory, and Reporting Services) are all suitable activities for a corporate credit union and support the operations of NPCUs by providing cost effective solutions and specialized knowledge that NPCU may lack. The IT activities meet the information systems and technology needs for small NPCUs while the ALM Consulting, Advisory, and Reporting services are necessary services CCUs offer to NPCUs for balance sheet and interest rate risk management, as well as to meet requirements as outlined in NCUA’s Rules and Regulations.

The activities are evaluated as having varying degrees of overall risk considered in the range of low to moderate for the CUSO service users. Standard risk types (reputation, operational, compliance, etc.) were considered with the greatest risk factors posed by these activities being reputation risk and operational risk. Adequate control mechanisms are available to mitigate known or perceived risks to acceptable levels and none of the activities would pose any level of systemic risk. Therefore, these activities are anticipated to pose minimal to no impact to the NCUSIF. OCCU recommends the CUSO activities and activity conditions listed in the table below be considered for approval by the board.

| Service Category – Information Technology Services | | |
|---|--|---|
| Activity | Description of Service | Activity Conditions |
| Web Development, Hosting, & Content Management | Developing and designing non-transaction public web sites, private or internal web sites, and web applications. Web site hosting to include maintaining the servers and html code for public and private web sites, intranets, and Web applications used on customer websites. Offering web content management (WCM) systems to simplify the publication of web content and updates to web sites and mobile devices. | Other Conditions: 1. Maintain business recovery plan ensuring uninterrupted operations. 2. Maintain bond/liability insurance appropriate for activity. 3. Adhere to audit standards for third-party service providers. 4. Annually provide OCCU copy of bond/liability insurance, business contingency plans & test results. |
| Web Authentication & Security Monitoring | Web security and monitoring services such as authentication and encryption of | Other Conditions: 1. Comply with the Security |

| Service Category – Information Technology Services | | |
|--|---|---|
| Activity | Description of Service | Activity Conditions |
| | passwords and other similar techniques for secure member login to intranets, extranets, and private websites; host based intrusion protection and detection; log monitoring; hacker-safe monitoring programs; and configuration and daily administration web security and other similar monitoring services. | <p>Program Requirements - Part 748 of the NCUA Rules and Regulations.</p> <ol style="list-style-type: none"> 2. Comply with NCUA and FFIEC Guidance for Authentication in an Internet Banking Environment as applicable. 3. Maintain bond/liability insurance appropriate for activity. 3. Adhere to audit standards for third-party service providers. 4. Annually provide OCCU copy of bond/liability insurance, business contingency plans & test results. |
| Software Systems Development / Application Programming Interface (API) Development | Designing, coding, testing and updating custom software system data programs and other code (e.g., scripts) for use by credit unions. Application Programming Interface (API) development includes developing, testing, and updating custom applications which interface with other existing credit union systems and applications such as core processing systems. | <p>Other Conditions:</p> <ol style="list-style-type: none"> 1. Comply with the Security Program Requirements - Part 748 of the NCUA Rules and Regulations. 2. Conduct independent code review for custom software systems and applications. 3. Maintain source code for custom developed software systems in escrow or in similar arrangement. |
| Secure Collaboration Services | Programs, systems, or sites for establishing secure communication channels for private document storage and distribution, and dissemination of confidential or sensitive information for the purpose of collaboration between authorized parties. | <p>Other Conditions:</p> <ol style="list-style-type: none"> 1. Comply with the Security Program Requirements - Part 748 of the NCUA Rules and Regulations. |

| Service Category – Information Technology Services | | |
|--|---|--|
| Activity | Description of Service | Activity Conditions |
| Information Technology (IT) Consulting and Management Services | Consulting and management services for IT infrastructure design and architecture, system security, administration, support, resource management and monitoring. Services include offering Software as a Service (SaaS), Infrastructure as a Service (IaaS), Platform as a Service (PaaS), and planning and management, and the provisioning ¹ of hardware and software for business continuity planning to include online data backup and recovery services. | Other Conditions: 1. Comply with the Security Program Requirements - Part 748 and Records Preservation Program and Records Retention Appendix – Part 749 of the NCUA Rules and Regulations. 2. Maintain bond/liability insurance appropriate for activity. 3. Annually provide OCCU copy of bond/liability insurance, vendor due diligence reports, security program, business contingency plans & test results. |

| Service Category – Investment/ALM | | |
|---|---|----------------------------------|
| Activity | Description of Service | Activity Conditions |
| Asset Liability Management (ALM) Consulting, Advisory, and Reporting Services | Consulting, advisory, and reporting services for balance sheet and interest rate risk management. This includes ALM interest rate risk modeling, measurement, and reporting; ALM model validation services; consulting services for ALM policy development, core deposit studies, lending pool analysis and valuations, and other similar services. | Other Conditions: None |

In addition to the Activity Conditions listed in the matrix, all corporate CUSOs engaged in these activities must provide NCUA with the following reports by the 25th of the first month after the quarter-end or year-end, unless indicated otherwise: Quarterly: Financial statements and performance reports; Annually: Annual report to Owners, audited financial statements (30 days after receipt), strategic plan, list of current owners with percentages of ownership, and descriptive list of all products and services provided by the CUSO.

Under Part 704.11, non approval of these CUSO activities will require the corporate credit union CUSO owner(s) to divest of these CUSO investments within 180 days.

RECOMMENDED ACTION: The NCUA Board:

- (1) Authorize the service category “Information Technology Services” and activities identified as Web Development, Hosting, & Content Management; Web

¹ Providing or supplying the actual IT hardware/software necessary for Business Continuity/Disaster Recovery.

Authentication and Security Monitoring; Software Systems Development / Application Programming Interface (API) Development; Secure Collaboration Services; and Information Technology (IT) Consulting and Management Services,

- (2) Authorize the service category "Investment/ALM" and activity identified as Asset Liability Management (ALM) Consulting, Advisory, and Reporting Services.

Scott Hunt
Director
Office of Corporate Credit Unions